

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CEA-01 CIAE-00 COME-00 EB-08
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P 080758Z FEB 77
FM AMEMBASSY BERN
TO SECSTATE WASHDC PRIORITY 3864
INFO USMISSION OECD PARIS PRIORITY

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PASS CEA, TREASURY, FRB

EO 11652: NA
TAGS: OECD ECON SZ
SUBJ: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC) REVIEW
OF SWITZERLAND

REF: OECD PARIS 3386

1. EMBASSY APPRECIATES RECEIVING ADVANCE SUMMARY OF
EDRC REVIEW OF SWITZERLAND. HOWEVER, WE DISAGREE WITH
THE MISSION'S CONCLUSIONS AND PROPOSED LINE OF QUESTIONING
(PARA 9 REFTEL) FOR FOLLOWING REASONS:

A. INFLATION: WE BELIEVE MISSION ANALYSIS OVEREMPHASIZES
FRANC APPRECIATION AS DETERMINANT FACTOR IN LOW 1976
INFLATION RATE. CONSUMER PRICE INDEX INCREASE OF ONLY
1.7 PCT IN 76 (6.7 PCT IN 75) REFLECTS
5.2 PCT REAL DECLINE IN IMPORT PRICES (INCLUDING
REAL DROP OF 8.5 PCT FOR RAW MATERIALS WHICH CONSTITUTE
OVER 40 PCT OF SWISS IMPORTS); 4 PCT INCREASE IN PRODUCTIVITY;
AND LOWER DOMESTIC DEMAND (RETAIL SALES OFF 0.3 PCT IN 76
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FOLLOWING 8.1 PCT DROP IN 75) AND NEARLY 1 PCT
POPULATION DECLINE IN 74 AND 75. GOVT PRICE AND WAGE
SURVEILLANCE PROGRAM ALSO PLAYED KEY ROLE IN KEEPING
COSTS DOWN. WITH LABOR'S CONSENT, WAGES HAVE JUST KEPT
PACE WITH CONSUMER PRICES. WE BELIEVE FOREGOING DEVELOPMENTS
WERE CHIEFLY RESPONSIBLE FOR KEEPING INFLATION RATE DOWN WITH
APPRECIATED FRANC AN ADDITIONAL BUT MINOR FACTOR.

B. EXCHANGE RATE: SWISS FRANC APPRECIATED 10.4 PCT IN 76 (12 PCT IN 75) ON TRADE WEIGHTED BASIS. SITUATION BASICALLY ONE OF GREAT DEMAND FOR LIMITED SUPPLY OF SWISS FRANCS. FACTORS INCLUDE 76 INFLATION RATE DIFFERENCES; 5.2 PCT DIFFERENCE BETWEEN AVERAGE FOREIGN AND SWISS INFLATION RATES ACCOUNTS FOR OVER HALF FRANC APPRECIATION. THOUGH CAPITAL MOVEMENTS PLAYED ROLE, MISSION SHOULD NOT DISREGARD IMPORTANT DEVELOPMENTS IN FOREIGN TRADE. IMPORTS IN 75 FELL 20.2 PCT BY VALUE (VOLUME DOWN 17.8 PCT) AND IN 76 WERE STILL 14 PCT (13.8 PCT BY VOLUME) BELOW 74 LEVEL. EXPORTS AS PERCENTAGE OF IMPORTS ROSE FROM 82.4 PCT IN 74 TO 100.5 PCT IN 76 WITH SF 173.6 MILLION TRADE SURPLUS, FIRST SURPLUS SINCE 1953 AND ONLY FOURTH THIS CENTURY. FOLLOWING EMBASSY ESTIMATES SHOW FOREIGN TRADE IMPACT ON SWISS BALANCE OF PAYMENTS:

(BILLIONS SF)	1974	1975	1976	
FOREIGN TRADE BALANCE		-7.58	-0.84	0.17
CURRENT ACCOUNT BALANCE		0.51	6.68	8.40
CAPITAL ACCOUNT	7.25	7.41	10.68	
CAPITAL EXPORTS	5.70	12.09	15.00	

C. CAPITAL MOVEMENTS: FOREGOING TABLE SHOWS CAPITAL EXPORTS IN 76 HIT RECORD LEVEL SF 15 BIL, UP 25 PCT FROM 75. FOREIGN BORROWERS WERE ATTRACTED BY SWISS INTEREST RATES WHICH STEADILY DECLINED IN HIGHLY LIQUID CAPITAL MARKET, AND MORE STABLE EXCHANGE RATE DURING SECOND HALF 76. SWISS MARKET ATTRACTED FOREIGN DEPOSITORS, DESPITE LOW INTEREST RATES, BECAUSE OF LOW LIMITED OFFICIAL USE

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INFLATION RATE AND EXPECTED FURTHER FRANC APPRECIATION. HOWEVER, WHEN FRANC APPRECIATED RAPIDLY IN SECOND QTR, SOME FOREIGN BORROWERS DEFERRED BORROWING AND SOME HASTENED TO MAKE EARLY REPAYMENT OF OLDER FRANC LOANS TO DISCOUNT EXPECTED FUTURE EXCHANGE LOSSES. THIS PUT FURTHER UPWARD PRESSURE ON THE FRANC. MEASURES TO STEM CAPITAL IMPORTS WERE INTRODUCED DURING SECOND QTR 76, PRIMARILY TO CURB INFLOW OF ITALIAN LIRA AND SPECULATION IN THE FRANC. OVER 60 PCT OF SWISS NATIONAL BANK FOREIGN EXCHANGE MARKET INTERVENTIONS WERE MADE DURING FIRST HALF 76, ESPECIALLY APR. POUND STERLING WEAKNESS ALSO CAUSED UPWARD PRESSURE ON FRANC WHICH DEPRECIATED SLIGHTLY IN LATE DEC. BAN ON BANK TRADE IN LARGE DENOMINATION ITALIAN LIRA NOTES WAS LIFTED END 76.

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PASS CEA, TREASURY, FRB

D. MONETARY POLICY: LIBERAL BUT CONTROLLED MONETARY POLICY WAS INTENDED AS COUNTER-CYCLICAL MEASURE TO BRING INTEREST RATES DOWN AND STIMULATE INVESTMENT NECESSARY TO BOOST DOMESTIC DEMAND WITHOUT FUELING INFLATION. LOW INFLATION RATE SHOWS POLICY HAS HAD NON-INFLATIONARY IMPACT. PUBLIC SECTOR BORROWING AND FOREIGN LOAN ISSUES HAVE HELPED KEEP MARKET LIQUIDITY UNDER CONTROL WITHOUT EXERTING UPWARD PRESSURE ON INTEREST RATES. IF RATES RISE, GOVT PLANS REDUCE ITS BORROWING AND CONSIDER LIMITING FOREIGN LOAN ISSUES. HOWEVER, LIQUIDITY REMAINS HIGH AND INTEREST RATES ARE EXPECTED TO DECLINE FURTHER UNTIL SUMER 77.

E. FISCAL POLICY: GOVT STIMULATIVE MEASURES HAVE BEEN MODES, 0.6 PCT OF GNP IN 76 (SF 906 MIL) AND SF 120 MIL FOR 77. COMBINED BUDGET DEFICITS OF CONFEDERATION, CANTONS AND CITIES HAVE RISEN FROM SF 2 BIL IN 75 TO SF 3.7 BIL IN 76 AND SF 4 BIL PROJECTED FOR 77. DEFICITS LARGELY REFLECT DECLINING REVENUES. FEDERAL DEFICIT CHIEFLY ACCOUNTED FOR BY ACCUMULATED FEDERAL RAILROAD DEFICITS FROM PRIOR YEARS. INFLATIONARY IMPACT OF GOVT OPERATION HAS COME FROM SMALL 75
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TAX HIKE AND 10 PCT AVERAGE RAIL FARE INCREASE IN 76. NEW GOVT INITIATIVES HAVE BEEN URGED TO STIMULATE THE ECONOMY. HOWEVER, PRESENT STATE OF PUBLIC REVENUES PROVIDE LITTLE ROOM FOR SUCH MEASURES. FEDERAL GOVT FEELS CONSTRAINED AWAIT OUTCOME OF JUN 77 REFERENDUM ON ITS LONG-TERM FINANCIAL

PROGRAM, INCLUDING INTRODUCTION OF VALUE ADDED TAX AND HIGHER DIRECT TAXES. VAT EXPECTED ADD SF 2.5 BIL ANNUALLY TO REVENUES BUT CONTINUED BUDGET DEFICITS EXPECTED UNTIL 1980. IF VOTORS APPROVE VAT, WHICH IS NOT ASSURED, GOVT WILL PROBABLY LAUNCH BROAD NEW PROGRAM IN FALL 77 TO STIMULATE ECONOMY, ESPECIALLY IF ECONOMY DOES NOT SHOW IMPROVED GROWTH RATE AND FORECASTS OF INCREASED UNEMPLOYMENT THIS YEAR PROVE CORRECT.

2. EMBASSY BELIEVES THAT THE MISSION COULD FOCUS ON 77 FORECASTS DURING THE REVIEW. GOVT EXPECTS NEW INVESTMENT TO DECLINE 2.6 IN 77, WITH CONSTRUCTION DOWN 4 PCT AND NO GROWTH IN NEW EQUIPMENT EXPENDITURES. UNIVERSITY OF LAUSANNE APPLIED ECONOMIC RESEARCH CENTER HAS FORECAST 77 INVESTMENT GROWTH OF 6.8 PCT, CONSTRUCTION INCREASING 5.3 PCT WHILE EQUIPMENT AND MATERIALS EXPENDITURES EXPECTED TO RISE 4.7 PCT. AERC BELIEVES THAT GREATER SWISS PRODUCTIVITY, INCREASED BUILDING PERMITS AND LOANS APPROVED LATE 76, COMBINED WITH DELAYED IMPACT OF GOVT INVESTMENT PROGRAMS, WILL PRODUCE GREATER INVESTMENT IN 77 THAN FORECAST. GOVT FORECAST MADE IN LIGHT OF PREDICTED FURTHER DECLINE IN SEVERAL IMPORTANT INDUSTRIAL BRANCHES AND INCREASED UNEMPLOYMENT. EMBASSY BELIEVES GOVT FORECAST MORE REALISTIC BUT FINDS OPTIMISTIC ECONOMETRIC STUDY INTERESTING. DAVIS

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